June 2, 2010

Dear Chairman Nelson:

We have had an opportunity to review the recommendations provided to the Citizens Commission by various stakeholder groups and are including our detailed comments below.

Overall, while there are several important suggestions in the materials provided to the commission, we are concerned about the relatively narrow focus of the recommendations offered by the stakeholder groups. For example, while the materials provided by San Diegans for Job Promotion, Creation & Retention (SDJPCR) list Health Services, Innovation & Professional Services, Advanced Manufacturing, Information Services, and Life Sciences as some of the top employers in the region, and among the leading prospects for future economic growth, few of the recommendations for increasing the economic competitiveness of the city and the region actually target these industries. Instead, the recommendations focus almost exclusively on the tourism and construction industries, two sectors that — according to the information provided by SDJPCR — contain the lowest proportion of well-paying jobs.

In addition, here are several more detailed comments:

1. **Business tax amnesty will do little to contribute to the economic competitiveness of San Diego**.

In its letter to the Small Business Advisory Board, the Commission requested input for ways to "increase economic opportunities for businesses and employees while maintaining and enhancing quality of life for residents." Unfortunately, the Advisory Board's primary recommendation — to implement a business tax amnesty program — does little to address these issues. Because a tax amnesty program will target *existing* business and reduce penalties related to *previous* operations, it will do little to increase *future* economic opportunities. In short, a retroactive business tax amnesty, though it may be desirable based on other policy criteria, cannot be justified as strategy to increase economic competitiveness.

2. **Recommendations for preserving and expanding the CCDC redevelopment model are misguided.**

We agree with the San Diego Industry coalition that the region "requires investments in housing and communities." However, we believe its recommendations for expanding the CCDC redevelopment model are misguided and will not effectively promote these policy goals. The recently completed CCDC performance audit and the various reports prepared by the San Diego County Grand Jury have noted numerous problems with San Diego's existing redevelopment structure and the governance of the city's nonprofit redevelopment arms. For example, the independent performance audit has noted that "it does not appear that CCDC has promoted economic development or social service delivery to the extent that CCDC's peers [in other California cities] have" and has noted that, under the organization's watch, the stock of affordable housing in CCDC project areas has fallen dangerously close to the minimum levels required by state law. In short, it appears that CCDC has not been particularly effective in promoting investment in either housing or communities, compared to alternative redevelopment governance models used by other large California cities.

3. **Logic of decreasing marginal returns argues against concentrating public investment in tourism.**

As the presentation from the San Diego County Hotel/Motel Association (SDCHMA) notes, San Diego enjoys many natural advantages that help explain the success of its tourism sectors. Among these, the Association lists the city's location, weather, and natural attractions. Given the city's natural advantage in this sector, the logic of decreasing marginal returns suggests that policymakers should target scarce resources toward other industries that do not enjoy similar advantages, as this is where a single dollar of additional spending is likely to have the largest impact. In particular, this suggests that the TOT revenue raised through the Tourism Marketing District would be better used for other economic development activities.

4. **SDCHMA's analysis of transient occupancy taxes (TOT) is misleading.**

In making the case against raising the TOT, the SDCHMA notes that San Diego's total TOT burden does not fall dramatically below the average for "15 major cities." As we've noted in previous letters, the selection of comparison cities often drives the conclusions from such analyses, and the SDCHMA provides little evidence that the cities included in its analysis provide the proper comparative benchmark. More importantly, the SDCHMA analysis of the TOT issue is misleading. While the SDCHMA argues that the city's lower TOT is necessary to assure its competitive cost advantage, it is important to note that visitors are concerned with the total cost of their stay (room rate plus TOT), rather than just the TOT itself.

Therefore, conclusions about how increasing the TOT will affect the city's tourism industry cannot be made without understanding how its room rates compare to other competing tourist destinations. For example, if San Diego's average room rate falls below the average for these destinations, the city can safely charge a *higher* TOT without sacrificing its cost advantage. Moreover, sound policy and basic economic logic suggests that it is the hotel operators who should pay the cost of competing with other cities, in the form of lower profits, rather than the public treasury, in the form of lower tax receipts.

5. **Replacing impact/linkage fees and benefit assessments with general taxes would trigger Proposition 13 vote requirements.**

Several stakeholders have suggested that San Diego should replace its development impact and linkage fees and its Facilities Benefit Assessments with broader-based taxes. It is important to note that these changes would reverse city policies in place since the 1970s, which require that future residents rather than existing taxpayers bear the cost of new development. While the merits of this policy are debatable, the Commission must keep in mind the fiscal impacts of any possible policy change.

Eliminating impact and linkage fees would greatly reduce the amount of revenue available to pay for the construction and maintenance of basic infrastructure. Replacing these fees and special assessments, which are exempt from Proposition 13, with broader-based taxes, which are covered by Proposition 13, would likely require a two-thirds vote of the electorate. It is highly unlikely that a sufficient number of current voters would be willing to pay higher taxes to, in effect, subsidize future development. For this reason, changes to existing impact and linkage fees should not be made without first identifying an alternative source of funding and ensuring that necessary voter approval has been secured *before* existing fees and assessments are changed or reduced.

We hope that the Commission finds these comments helpful, and are happy to provide additional details at your request.

Sincerely,

Steven P. Erie
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